IN THE

Supreme Court of the United States

October Term, 1978
Nos. 77-753, 77-754

INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA; LOCAL 705, INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, and LOUIS PEICK,

Petitioners,

vs.

JOHN DANIEL,

Respondent.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Seventh Circuit.

Motion for Leave to File Brief Amicus Curiae of Stephen W. Holohan in Support of the Respondent John Daniel and Brief Amicus Curiae.

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MOTION OF STEPHEN W. HOLOHAN FOR LEAVE TO FILE BRIEF AMICUS CURIAE.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Stephen W. Holohan respectfully moves this Court, pursuant to Supreme Court Rule 42(1), for leave to file the accompanying brief in this matter as amicus curiae in support of the Respondent John Daniel. In

support of this motion, Stephen W. Holohan shows as follows:

1. The parties in this action have refused to consent to Stephen W. Holohan filing an amicus curiae brief in support of Respondent John Daniel.

2. Stephen W. Holohan is a Los Angeles attorney, who is a plaintiff's attorney in a Rule 10b-5 litigation in the Central District of California, which litigation involves issues similar to those in the instant case.

3. There are issues presented in this case which transcend the interests of the parties. Those issues relate to omission cases, specifically the applicability of deceit elements, recklessness, and aiding and abetting.

WHEREFORE, it is respectfully moved and requested that Stephen W. Holohan be granted leave to file the accompanying brief as amicus curiae.

STEPHEN W. HOLOHAN, Esq.,
Attorney for Amicus Curiae.

Of Counsel:
NOBLE, CAMPBELL & UHLER.

BRIEF AMICUS CURIAE OF STEPHEN W. HOLOHAN.

Interest of the Amicus.

The interest of the amicus is the application of consistent theory in Rule 10b-5 matters.

Introduction and Summary of Argument.

A limitation on liability addressed in the Seventh Circuit decision is justifiable reliance on a material misrepresentation or omission causing them injury. The purpose of this brief is to demonstrate that justifiable reliance on an omission is a fiction spawned by *Affiliated Ute Citizens v. United States. Affiliated Ute Citizens* is linked to this case because it is the basis of the *Sundstrand Corp. v. Sun Chemical Corp.* decision which is cited in the *Daniel* decision.

The gist of the argument is that *Affiliated Ute Citizens* misread Rule 10b-5(2) in that the Rule does not forbid omissions to state material facts. Rather the Rule forbids omitting to state material facts necessary . . . to make the statements made . . . not misleading, in other words half truths requiring speaking defendants to disclose enough to prevent the words from being misleading.

The ramifications of *Affiliated Ute Citizens* are generally as follows:

1. *Reliance. Affiliated Ute Citizens* provides that positive proof of reliance is not a prerequisite to recovery under circumstances involving primarily a failure to disclose. If there has been a statement and an omission, a half-truth, then reliance does apply. If there has been no state-

ment and an omission, then Rule 10b-5(2) does not apply.

2. *Causation. Affiliated Ute Citizens* provides that the obligation to disclose and this withholding of a material fact establish the requisite element of causation, and cite *Chasins v. Smith, Barney & Co.* in support. Chasins based causation on reliance on recommendations without disclosure, a half-truth, and expressly predicated causation in fact on adequate reliance.
3. *Duty to disclose. Affiliated Ute Citizens* provides that there is an affirmatiave duty to disclose under Rule 10b-5. If liability is predicated on a breach of duty, then liability is predicated upon equity standards. This conflicts with *Ernst & Ernst v. Hochfelder* which expressly established scienter as intent, which is not an equity standard.
4. If the above is correct, then each prohibitive clause in Rule 10b-5 constitutes an independent basis for liability.
5. Rule 10b-5(3) as an independent basis for liability would supersede presently utilized aiding and abetting concepts.
6. Rule 10b-5(1) and Rule 10b-5(2) distinguish fraud and deceit. Recklessness has two distinct though related applications: recklessness as to circumstances (deceit . . . e.g. utterer not know whether statement is true or false) and recklessness as to consequences (actor not desire the consequence, but foresees the possibility and consciously takes the risk). Hence the theory of recklessness would vary depending upon

which clause the claim for relief was brought upon.

7. The definition of recklessness utilized in omissions contexts has been Professor Prosser's definition. First, if *Affiliated Ute Citizens* is not correct about omissions, neither can this definition be correct. Second, Professor Prosser's definition comes from a section in his treatise on aggravated negligence. This notion is incompatible with the *Ernst & Ernst v. Hochfelder* notion that in certain areas of the law recklessness is considered to be a form of intentional conduct for the purposes of imposing liability for some act.

I.

RELIANCE AND CAUSATION IN OMISSIONS CASES.

A statement within the Parade of Horribles section of the Daniel decision of the Seventh Circuit Court at 561 F.2d at 250-251 reads:

> Particular employees must show, in light of all the ambient circumstances, justifiable reliance on a material misrepresentation or omission causing them injury. If all material facts are disclosed in a manner comprehensible to the average worker, as in any other securities fraud case, no damage causation will exist under the securities laws. *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1049-1051 (7th Cir. 1977), certiorari denied ..... U.S. ....., 98 S.Ct. 225, 54 L.Ed. 2d 155.

Regarding reliance on an omission *Sundstrand* at 1048 states:

> With materiality established, reliance in an omissions case is presumed. *Affiliated Ute Citizens v. United States,* 406 U.S. 128.

Affiliated Ute reads at 406 U.S. 153-154 as follows:

> To be sure, the second paragraph of this rule specifies the making of an untrue statement of a material fact and the omission to state a material fact.

Rule 10b-5(2) reads in part:

> . . . (t)o omit to state a material fact necessary in order to make the statement made in light of the circumstances under which they were made not misleading.

At common law, this notion was called a half-truth in that the defendant does speak, he must disclose enough to prevent his words rfom being misleading. A half truth is a form of deceit.

The problem raised in this brief is illustrated in the chapter on Fallicies of Observation in John Stuart Mill's, *A System of Logic* (Volume VIII of The Collected Works, University of Toronto Press 1974) at 773 which in part reads:

> A fallacy of misobservation may be either negative or positive; either Non-observation or Mal-observation. It is non-observation, when all the error consists in overlooking, or neglecting, facts or particulars which ought to have been observed. It is mal-observation, when something is not simply unseen, but seen wrong; when the fact or phenomenon, instead of being recognized for what it is in reality, is mistaken for something else.

The view of this brief is that Rule 10b-5(2) has been misread in the *Affiliated Ute* decision insofar as that decision treats "the omission to state a material fact" as an independent ground for relief. A corollary view is that the latter part of Rule 10b-5(2) is nothing more or less than the half truth notion applied to the securities field. The *Affiliated Ute* decision obliquely illustrates this position. *Affiliated Ute Citizens* reads at 406 U.S. 154 as follows:

> The obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact. *Chasins v. Smith, Barney Co.*, 438 F.2d, at 1172.

Chasins at 1172 reads:

> Chasins relied upon Smith, Barney's recommendations of a purchase made without the disclosure of a material fact, purchased the securities recommended, and suffered a loss in their resale. Causation in fact on adequate reliance was sufficiently shown.

Clearly, this passage from *Chasins* evidences a half truth situation, *i.e.*, recommendations which mislead because of the omission of the material fact. In short, it is a classic deceit case. Moreover, *Chasins* explicitly bases causation in fact on reliance, and not an obligation to disclose and the withholding of a material fact as stated in *Affiliated Ute*.

The consequence of the mal-observation of Rule 10b-5(2) was the oft-cited *Affiliated Ute* passage.

> Under the circumstances, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense

that a reasonable investor might have considered them important in the making of this decision. See *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (CA 2 1968), cert. denied sub nom.; *Coates v. SEC*, 394 U.S. 976 (1969); 6 L. Loss, *Securities Regulation* 3876-3880 (1969 Supp. to 2d ed. of Vol. 3); A. Bromberg, *Securities Law Fraud—SEC Rule 10b-5* §§ 2.6 and 8.6 (1967).

Hence, while the "omission to state a material fact" was severed from its common law deceit antecedents, the decision immediately applied the elements of common law deceit to the freshly minted cause of action for omitting to state a material fact. The result was that the facts of the *Affiliated Ute* case did not evidence a statement. Hence, there was no statement, falsehood or half truth, to rely on. The decision then force fitted the concepts of deceit to the facts. Reliance was to be presumed or ignored, and materiality became paramount in what were called "circumstances, involving primarily a failure to disclose."

II.
AFFILIATED UTE: THE ROAD NOT TAKEN AND ITS CONSEQUENCES.

A fuller excerpt in *Affiliated Ute* reads at 406 U.S. 152-153:

> To be sure, the second subparagraph of this rule specifies the making of an untrue statement of a material fact and the omission to state a material fact. The first and third subparagraphs are not so restricted. These defendants' activities, outlined above, disclose, within the very language

of one or the other of those subparagraphs, a "course of business" or a "device, scheme, or artifice" that operated as a fraud upon the Indian sellers. *Superintendent of Insurance v. Bankers Life & Casualty Co., supra.* This is so because the defendants devised a plan and induced the mixed-blood holders of UDC stock to dispose of their shares without disclosing to them material facts that reasonably could have been expected to influence their decisions to sell. The individual defendants, in a distinct sense, were market makers, not only for their personal purchase constituting 8-⅓% of the sales, but from the other sales their activities produced. This being so, they possessed the affirmative duty under the Rule to disclose this fact to the mixed blood sellers. See *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167 (C.A. 2d 1970).

The decision performed some sleight of hand; a cause of action predicated upon clauses (1) and (3) of Rule 10b-5 was expressly noted by the decision, but having said that the decision was silent as to clauses (1) and (3) thereafter, and specifically found a cause of action for clause (2), because of an affirmative duty to disclose. A shorthand version of this result can be stated as follows: If an actor violates clauses (1) and (3) of Rule 10b-5, he will be liable for violating clause (2) of Rule 10b-5 for failure to disclose violations of clauses (1) and (3), but will not be liable for violating clauses (1) and (3) independently.

In *Ernst & Ernst v. Hochfelder*, it is stated at 425 U.S. 194:

> In this opinion the term "scienter" refers to a mental state embracing intent to deceive, manipulate, or defraud.

There is a conflict between *Ernest & Ernst* and *Affiliated Uute,* which the Supreme Court appears to be unaware, in that liability predicated upon a breach of a duty is an equity notion and liability predicated on intent is not, and the two are mutually exclusive.

Professor Salmond, in *Law of Torts,* (16th ed.) at 466 elaborates upon the equity nature of breaches of fiduciary duty in a deceit context:

> When there has been a breach of a special duty recognized in equity, whether arising from the fiduciary relationship of parties or the special circumstances of the cases, the defendant will be liable for "constructive" fraud even though he has no fraudulent intention. In such a case no damages can be given for tort, but the plaintiff will be given an indemnity for the loss he has suffered—an equitable remedy.

In *SEC v. Texas Gulf Sulphur Co.,* which was cited in *Affiliated Ute,* the Second Circuit Court states at 401 F.2d 848:

> Whether predicated on traditional fiduciary concepts (citation omitted), or on the "special facts" doctrine (citations omitted), the Rule is based in policy on the justifiable expectation of the securities market-place that all investors trading on impersonal exchanges have relatively equal access to material information.
>
> Thus, anyone in possession of material inside information must either disclose it to the investing

> public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.

Texas Gulf Sulphur like *Affiliated Ute* does not distinguish between the clauses of Rule 10b-5. Nevertheless, in light of *Ernst & Ernst* the duty standard is irreconcilable with the scienter requirement for Rule 10b-5 liability since equitable relief requires no intent. Hence, the alternative of establishing independent liability for violating the individual clauses of Rule 10b-5 appears feasible.

At the opening of the argument a citation from *Daniel* cited *Sundstrand. Sunstrand* involved recklessness, relied upon *Affiliated Ute,* and applied equitable concepts.

Equity comes into play in Sundstrand in connection with a duty to disclose, and recklessness. The interrlationship of these factors will be discussed under subheadings:

1. *Duty to disclose.* The Seventh Circuit Court states at 553 F.2d 1043:

> In this posture as a quasi-fiduciary with respect to Sundstrand, Meers had an affirmative common law duty to disclose material facts relating to the proposed merger.[13]

The distinction between liability for intent and breach of duty, as indicated by Salmond is not discussed, but applies.

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[13]In contrast, Ernst & Ernst did not owe a common law duty to the plaintiffs in *Hochfelder.* 425 U.S. at 192 n.9.

2. *Affiliated Ute.* The Seventh Circuit Court stated in part at 553 F.2d 1043:

> The district court held him liable for three independent reasons: (1) failure to disclose the Burke and Ernst & Ernst reports even though he had a duty to do so; . . .

This claim is predicated on the "omit to state a material fact"-"duty" concept of *Affiliated Ute.*

3. *Recklessness.* Because *Affiliated Ute* funnelled all Rule 10b-5 claims into Rule 10b-5(2) claims, the scope of the concept of recklessness has been misunderstood. First, a brief survey of recklessness will be presented, and then the definition of recklessness in the *Sundstrand* decision will be examined. An outline of the survey is:

A. Criminal Law
  1. G. Williams, The Criminal Law
    a. Recklessness as to circumstance
    b. Recklessness as to consequence
    c. Common element
    d. Wilful blindness
    e. Crimes requiring intention

B. Tort Law
  1. Reckless disregard for the truth
    a. Objective standard
      1. Holmes, The Common Law
    b. Subjective standard
      1. Derry v. Peek
  2. Recklessness as to consequence
    a. Subjective standard
      1. Restatement of Torts, §500
    b. Perception of risk
    c. Appreciation of extent and gravity of risk

C. Recklessness and Negligence
  1. LeFave and Scott, Criminal Law
  2. Prosser, Law of Torts

A. Criminal Law.

1. G. Williams, The Criminal Law (2d ed. 1961).

It is important to understand that recklessness has two distinct though related applications. A skeletal outline derived from the English treatise, *The Criminal Law,* by Professor Glanville Williams illustrates these applications, and is as follows:

a. *Recklessness as to circumstance*
(§54, at 149)

1. Involves knowledge of the circumstances, or of the possibility of the circumstances. It occurs where there are some circumstances, specified by law as part of the actus reus, which the actor does not positively know to be present in his own case, but which he consciously takes the risk of being present.

2. A good example is deceit or fraud. This can be committed intentionally or recklessly: intentionally where the falsity of the statement is known, recklessly where the falsity is not positively known but where the utterer does not know whether the statement is true or false. The leading authority is *Derry v. Peek* (1889).

b. *Recklessness as to consequence*
(§24 at 53, §26 at 62, §25 at 58)

1. Occurs when the actor does not desire the consequence, but foresees the possibility and consciously takes the risk.

2. Occurs where the consequence is foreseen not as morally or substantially certain but only as "probable" or "likely," or perhaps as "possible."

3. The subjective theory of recklessness requires that the defendant should have foreseen the degree of probability of the consequences which is held to make the act reckless.

4. It (recklessness) is like intention in that the consequence is foreseen, but the difference is that whereas in intention the consequence is desired, or foreseen as a certainty, in recklessness it is foreseen as possible or probable but not desired.

5. Recklessness is a branch of the law of negligence; it is that kind of negligence where there is foresight of consequences. The concept is therefore a double barrelled one, being in part subjective and in part objective. It is subjective in that one must look into the mind of the accused in order to determine whether he foresaw the consequence. If the answer is in the affirmative, that is the end of the subjective part of the enquiry and the beginning of the objective part. One must ask whether in the circumstances a reasonable man having such foresight would have proceeded with his conduct notwithstanding the risk. Only if this second question, too, is answered in the affirmative is there subjective recklessness for legal purposes. If the first requirement is negatived one may still proceed to ask the second question, but the result can only be to establish inadvertent negligence.

c. *Common element* (§54 at 149)

1. The element common to the two kinds of recklessness is the conscious taking of the risk.

d. *Wilful blindness* (§57 at 157-159)

1. To the requirement of actual knowledge there is one strictly limited exception. Men readily regard their suspicions as unworthy of them when it is to

their advantage to do so. To meet this, the rule is that if a party has his suspicions aroused but then deliberately omits to make further inquiries, because he wishes to remain in ignorance, he is deemed to have knowledge.

2. In other words, there is a suspicion which the defendant deliberately omits to turn into certain knowledge. This is frequently expressed by saying that he "shut his eyes" to the fact, or that he was "wilfully blind".

3. There must have been something to put the accused on enquiry. Hence, . . ., it was held to be wrong to direct the jury that if a man is reckless and does not care, he is just as guilty as if he received the property, knowing at the time that there was something wrong with it. Recklessness and "not caring" are not quite the same thing as wilful blindness; such words express the latter doctrine rather too widely.

e. *Crimes requiring intention or recklessness* (§27 at 64-65)

1. It is a general, though not a universal, principle that recklessness is classed with intention for legal purposes. The thing that usually matters is not desire of consequence but merely foresight of consequence, which is the factor common to intention and recklessness. It is this foresight of consequence that, it is submitted, constitutes mens rea. Consequently, every crime requiring mens rea, if it does not positively require intention, requires either intention or recklessness. This holds for crimes of perjury or (it seems) deceit or obtaining by false pretenses; in these the accused may either know that his statement is false (intention) or realize the possibility of falsity and

yet affirm the statement as though it were true (recklessness).

B. Tort Law.

1. Reckless Disregard for the Truth.

a. *Objective standard*

1. *Holmes, The Common Law* (1881) (108-109)

But again, it is enough in general if a representation is made recklessly, without knowing whether it is true or false. Now what does "recklessly" mean. It does not mean actual personal indifference to the truth of the statement. It means only that the data for the statement were so far insufficient that a prudent man could not have made it without leading to the inference that he was indifferent. That is to say, repeating an analysis which has been gone through with before, it means that the law, applying a general objective standard, determines that, if a man makes a statement on those data, he is liable, whatever was the state of his mind, and although he individually may have been perfectly free from wickedness in making it.

b. *Subjective standard*

1. *Derry v. Peek,* 14 App.Cas. 337, 374 (1889)

I think the authorities establish the following propositions: First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false . . .

Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states . . . Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.

2. Recklessness as to Consequence.

a. *Subjective standard*

1. *Restatement of Torts (1939), § 500 Reckless Disregard for Safety Defined, Vol. 2 at 1293-95*

The actor's conduct is in reckless disregard of the safety of another if he intentionally does an act or fails to do an act which it is his duty to the other to do, knowing or having reason to know of facts which would lead a reasonable man to realize that the actor's conduct not only creates an unreasonable risk of bodily harm to the other but also involves a high degree of probability that substantial harm will result to him. Comments:

b. Perception of risk. Conduct cannot be in disregard of the safety of others unless the act or breach of duty is itself intended, notwithstanding that the actor knows of facts which would lead any reasonable man to realize the extreme risk to which it subjects the safety of others.

c. Appreciation of extent and gravity of risk. In order that the actor's conduct may be reckless, it is not necessary that he himself recognize it as being extremely dangerous. His inability to realize the danger

may be due to his own reckless temperament or to the abnormally favorable results of previous conduct of the same sort. It is enough that he knows or has reason to know of circumstances which would bring home to the realization of the ordinary, reasonable man the highly dangerous character of his conduct.

C. Recklessness and Negligence.

1. Le Fave and Scott, Criminal Law (1972) at 215.

It would seem most desirable that courts, legislatures and text writers should standardize their language with reference to the types of negligence which criminal law requires in order to make for clarity in communication. In this book, the word "negligence" is thus used to indicate conduct which will qualify for tort liability, *i.e.*, conduct creating an unreasonable risk, measured by the objective standard. "High degree of negligence" means conduct creating a high degree of risk (higher than just an unreasonable risk), also measured by the objective standard. "Recklessness" means conduct involving a high degree of risk, of which risk the actor is subjectively aware. The more ambiguous expressions, like "gross negligence" and "culpable negligence" and "wilful and wanton" conduct, will not be used, except when discussing statutes so phrased.

2. Prosser, Law of Torts (4th ed. 1971) at 185.

The usual meaning assigned to "wilful", "wanton", or "reckless", according to the word used is that the actor has intentionally done an act of an unreasonable character in disregard of a risk known to him or so obvious that he must be taken to have been aware of it, and so great as to make it highly probable that harm would follow.

The result is that "wilful", "wanton", or "reckless" conduct tends to take on the aspect of highly unreasonable conduct, or an extreme departure from ordinary care, in a situation where a high degree of risk is apparent. As a result there is often no clear distinction at all between such conduct and "gross" negligence, and the two have tended to merge and take on the same meaning, of an aggravated form of negligence, differing in quality rather than in degree from ordinary lack of care.

In *Sundstrand,* the Seventh Circuit Court stated:

> Apparently the only post-*Hochfelder* reported definition of recklessness in the context of omissions appears in *Franke v. Midwestern Oklahoma Development Authority,* CCH Fed. Sec. L. Rep. ¶95,786 at 90,850 (W.D. Okl. 1976).
>
> "reckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."

As the Supreme Court conceded in *Hochfelder:*

> "In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act." 425 U.S. at 193-194 n. 12.

The *Franke* definition of recklessness is "the kind of recklessness that is equivalent to wilful fraud." *SEC v. Texas Gulf Sulphur Co.,* 401 F.2d 833, 868 (2d Cir. 1968) (Friendly, J., concurring) (en banc), certiorari denied sub om. *Coates v. SEC,* 394 U.S. 976.

The problems with the *Franke* definition are numerous.

First. One of the arguments in this brief is that the notion of liability based on an omission predicated upon *Affiliated Ute* is a fiction. If so, a definition of recklessness as to an omission is similarly a fiction.

Second. The definition of recklessness used in *Franke* originated in *Prosser,* which definition is in the outline immediately above. If the *Franke* definition of recklessness is "the kind of recklessness that is equivalent to wilful fraud", why did Professor Prosser include it in his section on Aggravated Negligence? Further, in his section on Intent, Professor Prosser states at 31-32:

> Intent, however, is broader than a desire to bring about physical results. It must extend not only to those consequences which are desired, but also to those which the actor believes are substantially certain to follow from what he does.
>
> The practical application of this principle has meant that where a reasonable man in the defendant's position would believe that a particular result was substantially certain to follow, he will be dealt with by the jury, or even by the court, as though he had intended it.
>
> Apparently the line (between intent and negligence) has been drawn by the courts at the point where the known danger ceases to be only a foreseeable risk which a reasonable man would avoid, and becomes a substantial certainty.

This language compares favorably with Professor Williams' concept of recklessness as to consequences outlined above. The views of Professor Prosser and Professor Williams differ as to the degree of probability of the consequence:

A. *Prosser:* Substantially certain.

B. *Williams:* Probable or likely, or perhaps as possible.

In other matters, Professors Prosser and Williams seem to agree. Common elements are:

A. Subjective element

1. Foresight of the consequences

B. Objective element

1. A reasonable man test in light of such foresight

Since Professor Williams writes that recklessness is like intention in that consequences are foreseen, this concept is compatible with the *Ernst & Ernst* notion of recklessness being a form of intentional conduct for purposes of imposing liability. It is submitted that the Prosser-Williams notion is the appropriate notion of reckless conduct for Rule 10b-5 matters.

This brief leaves open the question of what degree of probability of the consequences is necessary to make the act reckless. Professor Williams illustrates the mechanics of the concept as follows:

> The subjective theory of recklessness requires that the defendant should have foreseen the degree of probability of the consequences which is held to make the act reckless. Since the probability of an event rests upon knowledge or experience, one must take the actual knowledge and experience of the accused if the subjective test is to be maintained.

Third. The concluding language of the *Franke* definition "or is so obvious that the actor must have been aware of it", is an example of simple negligence which inarguably was banished by *Ernst & Ernst.*

Fourth. Should the occasion arise where the *Franke* definition is construed to include a duty notion, since *Texas Gulf Sulphur* is cited, the language in Torts § 500 is instructive. In comment b. Perception of risk, it is stated:

> Conduct cannot be in disregard of the safety of others unless the act or breach of duty is itself intended, notwithstanding that the actor knows of the facts which would lead any reasonable man to realize the extreme risk to which it subjects the safety of others.

This is language which is compatible with *Ernst & Ernst's* notion of intent. Moreover, it is important to point out that it is not the breach of duty which is objectionable, but rather the intended breach of duty. This Restatement, then, illustrates and reconciles the conflict between *Ernst & Ernst* and *Affiliated Ute.*

Consequently, the *Affiliated Ute* decision by not distinguishing between the clauses, and the *Ernst & Ernst* decision by not being aware of the conflict with *Affiliated Ute* has impeded the application of recklessness to the securities field.

Fifth: Sundstrand also states at 1045:

> While this definition might not be the conceptual equivalent of intent as a matter of general philosophy, it does serve as a proper legally functional equivalent for intent, because it measures conduct against an external standard which, under the circumstances of a given case, results in the conclusion that the reckless man should bear the risk of his omission. See O. Holmes The Common Law 130-163. . .

Holmes' view as stated in the excerpt in the survey is an objective standard, *i.e.,* data from the statement were so far insufficient that a prudent man could not have made it without leading to the inference that he was indifferent. *Ernst & Ernst* requires intent or recklessness that is considered to be a form of intentional conduct. Professor Williams emphasizes that the common element to the two kinds of recklessness is the conscious taking of the risk. Neither *Ernest & Ernst's* nor Professor Williams' view would equate intent or conscious taking of a risk with indifference judged objectively. On recklessness, Holmes is in conflict with *Ernst & Ernst.*

Sixth, if the independent clauses of Rule 10b-5 provide alternative bases of liability, then by juxtaposing the definitions of aiding and abetting and Rule 10b-5(3) the two concepts are strikingly similar.

A. Aiding and Abetting. (Williams, The Criminal Law (2d ed. 1961) at 346).

A person is guilty of aiding and abetting if he is . . . anyone who knowingly assists or encourages at the time of the crime, whether present or not.

B. Rule 10b-5(3).

To engage in any act, practice or course of business which operates as a fraud or deceit upon any person.

If Rule 10b-5(3) were to supersede aiding and abetting, then the scienter standards of *Ernst & Ernst* and recklessness would apply. A by-product would be that

the nettlesome question of whether the aider and abettor's conduct was substantial assistance would disappear.

An epilogue to this brief is that all of the ideas have been anticipated by Professors Bromberg and Jacobs as follows:

A. *Bromberg. Securities Law: Fraud, Sec. 2.-6(3), 52-53 (1975)*

Of course it makes no difference which clause is used in a given case, if all of them are violated, or if none is. In between, we might expect a careful consideration whether the clauses related to different things, and that the meaning of one is affected by the context of the other. But as in 10b-5's relations to other fraud rules, things just do not work out that tidily, and few people are concerned about it.

B. *Jacobs. The Impact of Rule 10b-5 (1975) at 157*

This overlap matters only if courts look at the Rule as three separate provisions and glean different elements of a cause of action from each.

Conclusion.

If there is to be theoretical consistency in Rule 10b-5 matters, *Ernst & Ernst* and *Affiliated Ute* must be reconciled.

The Seventh Circuit Court foresaw a limitation of liability in a pension plan securities violation because disclosure will preclude a violation and because a plaintiff must show justifiable reliance on a material misrepresentation of omission causing them injury. This brief

submits that Rule 10b-5(2) deals with representations and omissions not just omissions. Where there is just an omission, *i.e.*, acts without representations which violate Rule 10b-5(1) or (3) and not the deceit clause Rule 10b-5(2), deceit elements will be inapplicable. Hence, justifiable reliance would not limit liability. The facts of *Daniel* are tailor-made representations and omissions, *i.e.*, deceit, facts, and it is to those facts taken together which the scienter standards ought apply. As long as *Affiliated Ute* stands, such an interpretation is unlikely regardless of the literal reading of Rule 10b-5.

Respectfully submitted,

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